Governor George W. Bush:

"A Tax Cut with a Purpose"

" My tax cut plan is not just about productivity, it is about people. Economics is more than narrow interests or organized envy. A tax plan must apply market principles to the public interest. And my plan sets out to make life better for average men, women and children."

– Governor George W. Bush

EXECUTIVE SUMMARY

Governor Bush's Bold Approach to Tax Cuts

Federal taxes are the highest they have ever been during peacetime. Americans now work more than 4 months a year on average to fund government at all levels. High taxes unfairly limit the participation of low-income earners, middle-class families, and seniors in today's prosperity, and act as a success tax on entrepreneurs. **That is why Governor Bush is proposing a bold tax cut plan that will not only ensure continued prosperity – and leave the Social Security surplus untouched – but give that prosperity a purpose.**

Governor Bush's tax plan focuses on cutting marginal tax rates, a powerful way to raise standards of living. **The Bush tax plan will replace the current five-rate tax structure of 15, 28, 31, 36, and 39.6 percent with four lower rates: 10, 15, 25 and 33 percent. This would mean lower taxes for all Americans, providing $460 billion of tax relief over 5 years.**

The highest percentage cuts will go to those taxpayers with the lowest incomes:

- A family of four making $35,000 a year will receive a 100 percent income tax cut.
- A family of four making $50,000 a year will receive a 50 percent income tax cut.
- A family of four making $75,000 a year will receive a 25 percent income tax cut.

Overall, the marginal income tax rate on low-income families will fall by over 40 percent, and six million American families – one in five taxpaying families with children – will no longer pay any income tax at all.

Governor Bush's Tax Cuts Focus On Five Priorities

The Bush tax cut plan focuses on five priorities:

(1) **To Increase Access to the Middle Class for Hard-Working Families,** Governor Bush's plan will:

- Cut the current 15 percent tax bracket to 10 percent for the first $6,000 of taxable income for singles, the first $10,000 for single parents, and the first $12,000 for married couples.
- Double the child tax credit to $1,000.

(2) **To Treat All Middle Class Families More Fairly,** Governor Bush's plan will:

- Cut the maximum marginal tax rate for the middle class to 25 percent (versus the current maximum rates of 28 and 31 percent).

- Greatly reduce the marriage penalty by restoring the 10 percent deduction for two-earner families, allowing them to deduct up to an additional $3,000.
- Raise the threshold for the phase-out of the child tax credit from $110,000 to $200,000 for married couples, and from $75,000 to $200,000 for single parents.

(3) To Encourage Entrepreneurship and Growth, Governor Bush's plan will**:**
- Cap the top marginal tax rate at 33 percent (down from the current 39.6 percent).
- Eliminate the death tax.
- Make the Research and Development tax credit permanent.

(4) To Promote Charitable Giving and Education, Governor Bush's plan will:
- Extend the deduction for charitable contributions to the 80 million taxpayers that do not itemize, and raise the cap on corporate giving.
- Increase the annual contribution limit on Education Savings Accounts from $500 to $5,000 per child.

(5) To Allow Seniors to Work Without Penalty, Governor Bush's plan will:
- Eliminate the Social Security earnings test.

Governor Bush's Tax Cuts Make the Tax Code Fairer

Governor Bush's income tax cuts will benefit all Americans, but they are especially focused on low and moderate income families:
- Roughly $3 out of every $6 returned to taxpayers would finance changes that help low income families gain access to the middle class: the new 10 percent bracket and the doubling of the child tax credit.
- $2 out of every $6 returned to taxpayers would finance changes that treat middle class families more fairly: the new 25 percent bracket, marriage penalty relief, and the higher phase-out threshold for the child tax credit.
- $1 out of every $6 returned to taxpayers would go to entrepreneurs and creators of wealth.

Governor Bush's Tax Cut Plan Preserves the Social Security Surplus

Governor Bush's tax cuts will be financed exclusively out of the non-Social Security surplus.
- Governor Bush supports Social Security "lock box" legislation, which would wall off the Social Security surplus from the rest of the budget.

Governor Bush's Tax Plan is Realistic

The baseline economic projection underlying the plan assumes a realistic growth rate of 2.8 percent – considerably lower than recent experience.
- Under the baseline projection, the Bush income tax cuts would be phased in over five years – the official horizon of the President's budget.

I. The Relationship Between Taxes and Economic Growth

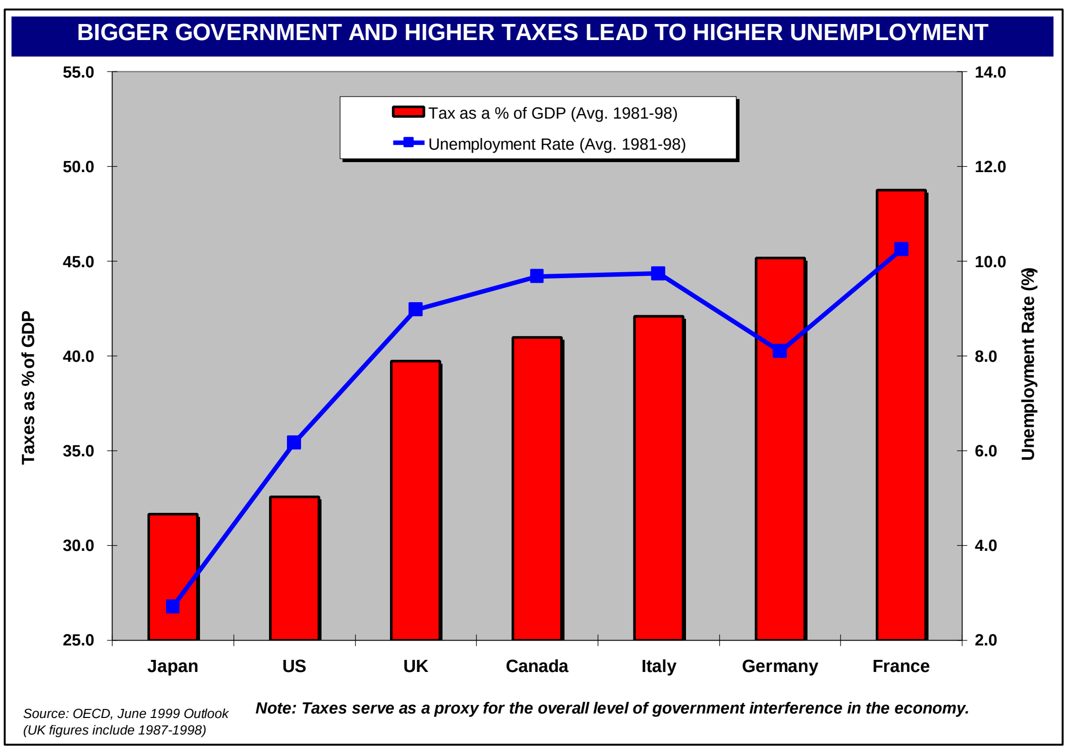
Governor Bush recognizes that continued economic growth will require a coordinated economic plan that preserves Social Security and Medicare, reduces the national debt, eliminates outdated regulations, controls the growth of government spending, deters frivolous lawsuits, embraces free trade, and promotes monetary policies that keep inflation low.

One of the most powerful tools the federal government has to raise standards of living is to lower marginal tax rates. That is why Governor Bush's tax plan focuses on cutting marginal rates where they impose the greatest obstacle to economic well-being. His tax plan promotes the values that make the American economy second to none: access to the middle class, family, equal opportunity, and the entrepreneurial spirit.

Limited Government and Lower Taxes Promote Growth

Economic studies comparing countries over long periods of time have confirmed that excessively large governments, and government distortion of markets, tend to lower economic growth. The reason is clear: large governments require high taxes, and high taxes distort markets. In developed economies, large governments are also correlated with lower per capita income and higher unemployment (see Chart 1).

CHART 1



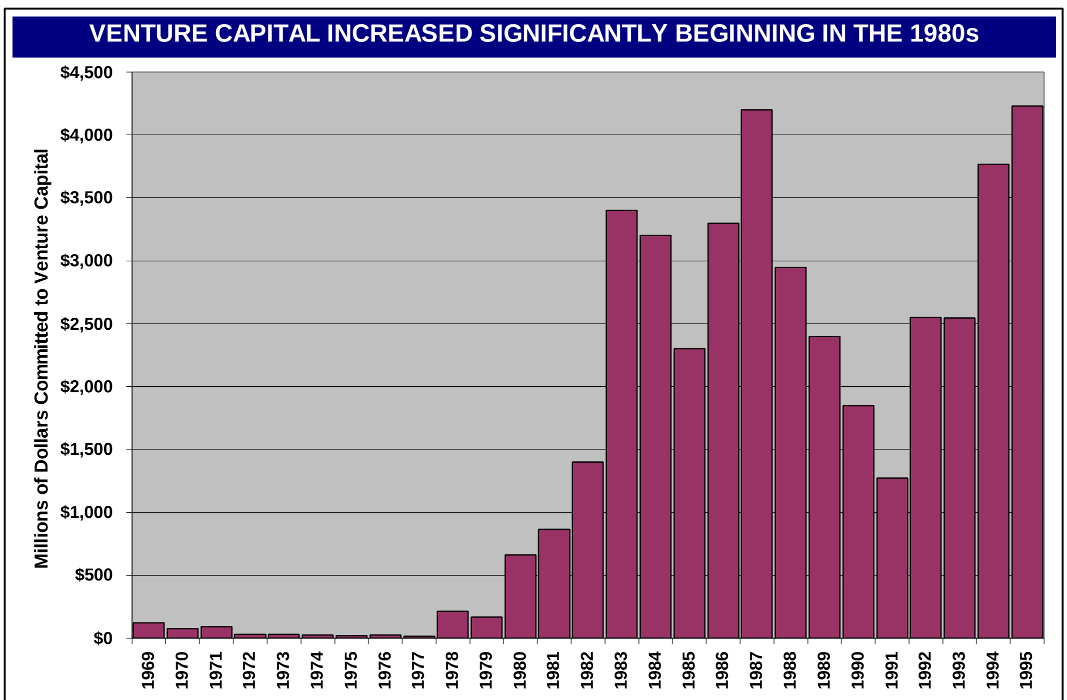
These academic studies indicate that wealth is created by hard-working, risk-taking individuals, not government programs. Countries with low taxes, limited regulation, and open borders grow faster, create more jobs, and enjoy higher standards of living than countries with bigger, more centralized governments and higher taxes. Thus, it is no coincidence that the technology revolution is being led by the United States. And it is no accident that the United States has significantly less unemployment than other nations. America is simply a freer country. If people are given the freedom to create, they do. If people are given a stake in the outcome, they succeed.

Cutting Marginal Tax Rates Raises the Standard of Living

The marginal tax rate is the tax on each additional dollar of income. The lower the marginal rate, the greater the incentive to find a better job, to save for the future, or start a new business. Lower marginal tax rates also encourage households to save, which in turn increases the funds available for capital formation. Equally important, lower tax rates leave more resources with innovative entrepreneurs, instead of funding government bureaucracies.

The foundation for today's prosperity was laid in the 1980s through the reduction of marginal tax rates, the taming of inflation, the opening of global markets, the restructuring of corporations, and the winning of the Cold War. Under strong leadership, the malaise and stagflation of the 1970s melted away into the prosperity of the 1980s. And the economic growth of the 1980s provided the venture capital to seed the technology revolution of the 1990s (see Chart 2).

CHART 2



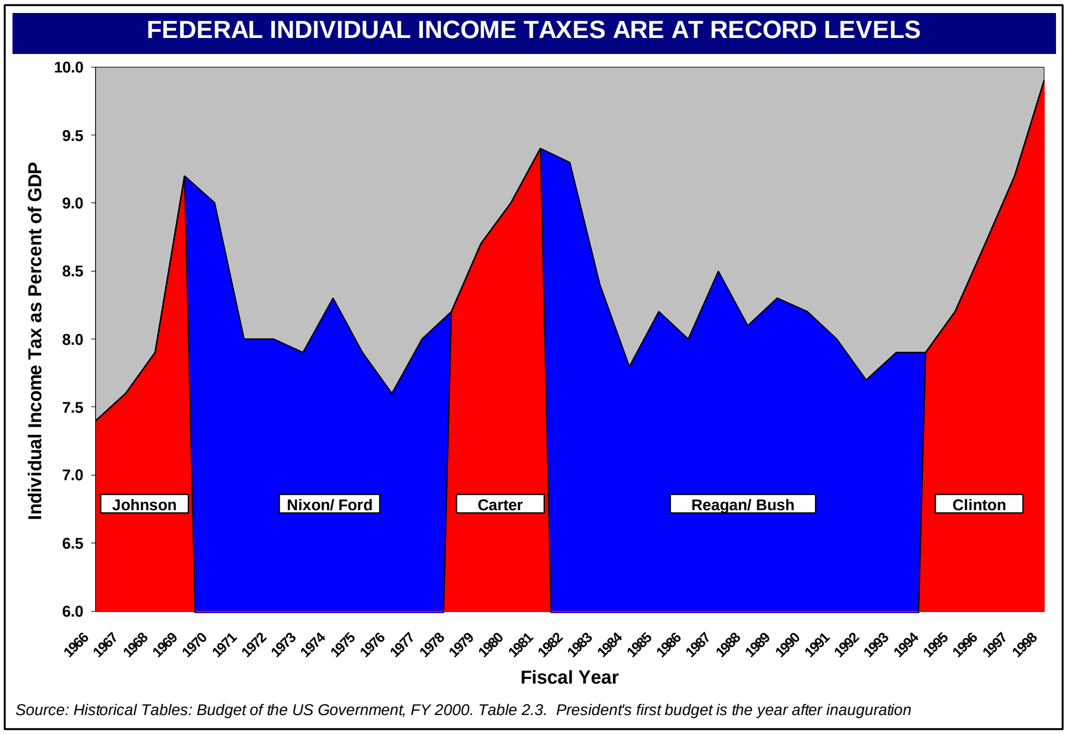
Source: Science & Engineering Indicators-- 1998, based on Venture Economics data

The turning point for the economy came on August 13, 1981, when President Reagan signed into law the largest tax cut in American history. The 25 percent across-the-board cut in income taxes, combined with prudent deregulation and anti-inflation monetary policy, helped unleash the longest economic boom in the 20th century. Since 1982, over 40 million jobs have been created and the Dow Jones Industrial Average has surged from less than 1,000 to over 10,000 today. The roaring economy briefly slowed in 1990, when the Gulf War began. It regained steam in the spring of 1991, and surged ahead in 1997 under the power of the technology revolution. The economic and strategic victories of the 1980s created a strong economy and permitted a downsizing of defense, which together generated today's budget surplus.

II. <u>The Need to Cut Today's Record High Taxes</u>

Federal income taxes have risen dramatically in the 1990s (see Chart 3). Today, federal taxes from all sources are the highest they have ever been during peacetime. Even worse, taxes at all levels of government absorb 36 percent of net national product.

CHART 3



Because of the unprecedented economic growth our country is experiencing, the current high level of taxation is generating ever-larger surpluses. Lawmakers are using these surpluses to fuel the growth of the federal government. In contrast, Governor Bush believes that a government with unlimited funds becomes a government with unlimited reach. Thus, as President, he would leave excess tax money with the people who earn it.

Access to the Middle Class

High marginal tax rates act as a tollgate, limiting the access of low and moderate income earners to the middle class. The belief that any worker, with enough effort, can join the middle class is at the heart of the American Dream. But when government attempts to help the poor by simply redistributing income, it often undermines incentives to work harder and earn more.

For example, because the benefit of the Earned Income Credit diminishes as a worker's income increases, a single mother with two children on the outskirts of poverty will lose half of any additional dollar she earns (taking into account social insurance taxes and state income taxes). The benefit of taking an extra training course or working an extra shift is cut in half by the government. As a result, a single mother with two children earning $22,000 a year faces a higher marginal tax rate than a lawyer earning $220,000. Lowering these barriers to the middle class is one of Governor Bush's top priorities.

The Success Tax

The tax cuts of the 1980s helped generate the venture capital that is now fueling the growth of the Internet and other technologies. New technologies are boosting productivity and economic growth by helping companies achieve new efficiencies. In this environment, entrepreneurship has become the path to prosperity for many minorities, women, and young people. Yet, today's high marginal tax rates tend to penalize continued innovation and business formation and expansion.

High marginal tax rates inhibit entrepreneurial activity because they act as a success tax, claiming a larger share of income from flourishing enterprises, while the government shares little of the risk of loss. For most entrepreneurs, income taxes reduce their companies' cash flow – the money businesses need to expand, buy more equipment, and hire more workers.

To ensure continued innovation, Governor Bush believes the tax system should be revised to restore incentives for success. In this period of revolutionary technological change, the government should leave as many resources as possible with the entrepreneurs and companies that are generating new ideas, better jobs, and greater wealth.

The Tax Burden on Families

The current level of taxes is so high that, on average, families now pay more in total taxes than they spend on housing, food, and clothing combined. These high taxes force families to work harder each year to fuel a growing government. Indeed, on average, Americans now work over four months of the year to fund government at all levels.

This high tax burden strips families of resources needed to solve their most pressing problems. Every family faces different challenges: some need better childcare, some need tutoring for their children, and others need a greater variety of after-school programs. Government cannot tailor its programs to the needs of each family. That is why Governor Bush believes that the best way to help *all* families is to let each family keep more of its income – and spend it as it deems appropriate.

The Debt Burden on Working Americans

Consumer debt has reached an all time high and now approaches $1.4 trillion. Credit card debt alone totals nearly $600 billion, more than $2,000 for every man, woman, and child in the country. Because auto loans and other forms of debt are also at all time highs, just servicing consumer debt takes a bigger share of income than ever before. Tax relief would give families the ability to pay off their debt without cutting critical family investments, such as quality childcare, medical check-ups, or adequate computers.

A Timely Second Wind

The current high level of taxation provides little or no insurance against a potential economic downturn. Economic history teaches the importance of keeping an eye on the horizon, especially when the economy is performing well. That is why Governor Bush advocates cutting taxes now: the best way to ensure that prosperity continues is to put more wealth in the hands of the entrepreneurs and creators of wealth. A tax cut will give the economy a timely second wind.

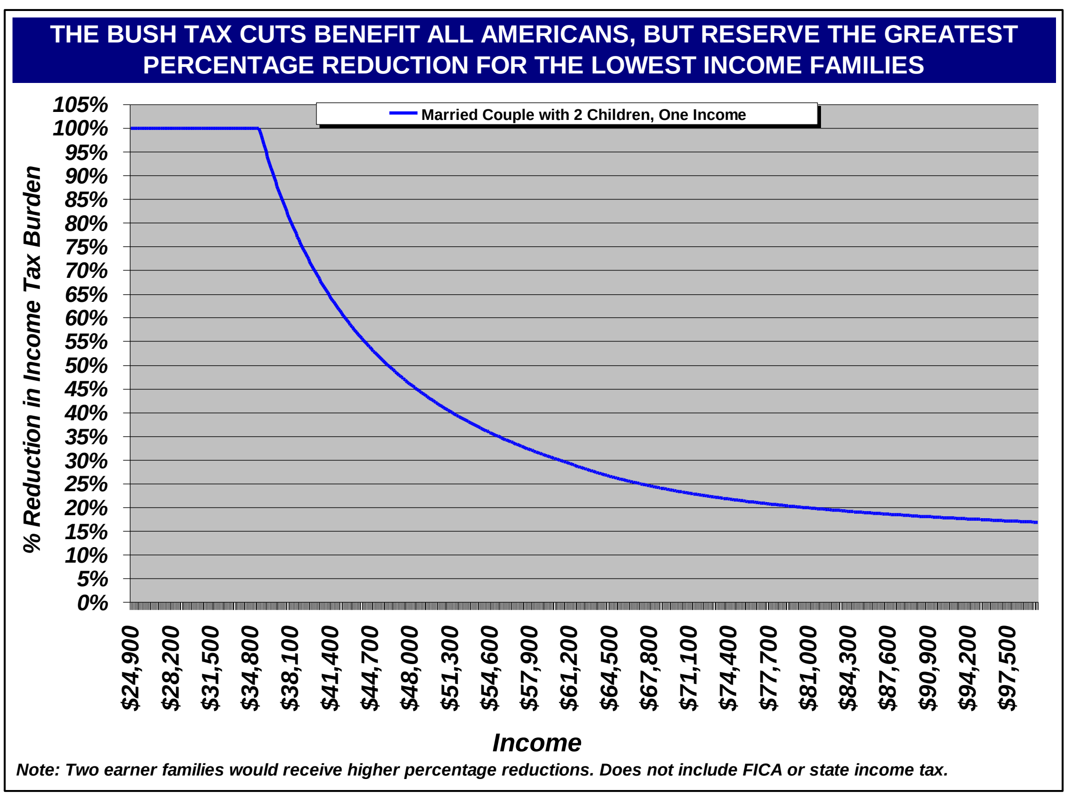
III. <u>The Tax Cut Plan of Governor Bush</u>

A Bold Approach

Governor Bush's tax cut plan would convert the income tax code into a simpler, flatter, and fairer tax system. His approach focuses on reducing marginal rates to spur and sustain economic growth. Lower marginal rates will give all workers the freedom to succeed, raising standards of living generally. Accordingly, under the Bush tax cut plan, the current five-rate tax structure of 15, 28, 31, 36, and 39.6 percent would be replaced with four lower rates: 10, 15, 25 and 33 percent.

This new, flatter rate structure would mean lower taxes for all working Americans. Because Governor Bush believes that a free society must also be a just society, the highest percentage cuts would go to those families and individuals with the lowest incomes (see Chart 4). Recognizing that prosperity should have a purpose, the Bush tax cut plan focuses on five priorities.

CHART 4



Priority #1: Increasing Access to the Middle Class for Working Families

The current tax code's high marginal rates serve as a barrier to the middle class for many low income families. Because the benefit of the Earned Income Credit diminishes as workers earn more, many families face punitive marginal rates that serve as a powerful disincentive to assume extra responsibility at the office, work an extra shift, take technical training, or invest in a higher educational degree.

Thus, to provide a greater reward for those who make the sacrifices needed to move ahead, one-half of the revenue cost of the Bush income tax cuts would finance changes designed to help low-income families enter the middle class. Specifically, Governor Bush's tax cut plan would:

<ins>Substantially Lower the Marginal Tax Rate for Low Income Parents</ins>: Under the Bush tax cut plan, the marginal income tax rate would fall by over 40 percent for low income families with two children, and by nearly 50 percent for families with one child (see Chart 5). This results from two key changes in the tax code:

- The current 15 percent tax bracket would be cut to 10 percent for the first $6,000 of taxable income for singles, the first $10,000 for single parents, and the first $12,000 for married couples; and
- The existing child tax credit would be doubled to $1,000 (and count against the AMT).

As a result of these changes, six million families – one in five taxpaying families with children – would no longer pay any federal income tax (see Chart 6).

CHART 5

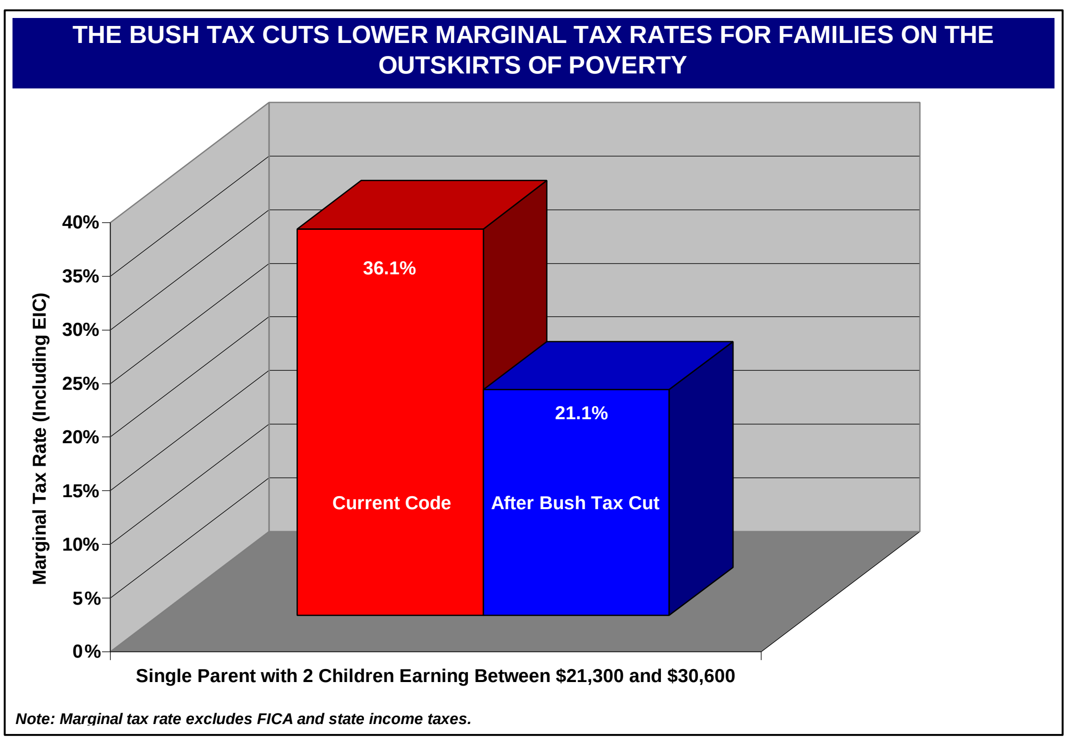


CHART 6

THE BUSH TAX CUTS REMOVE OVER SIX MILLION LOWER AND MODERATE INCOME FAMILIES FROM THE FEDERAL TAX ROLLS

	Minimum Income Before Paying Income Taxes	
Filing Status	**Current Tax Code**	**After Bush Tax Cuts**
Married Filers:*		
Married with 1 Child	**$18,800**	**$26,200**
Married with 2 Children	**$24,900**	**$36,500**
Single Filers:		
Head of Household w/ 1 Child	**$15,200**	**$21,900**
Head of Household w/ 2 Children	**$21,300**	**$31,300**
Single Filers	**$7,100**	**$7,100**
TOTAL FILERS REMOVED FROM THE TAX ROLLS:		**6 MILLION**

****Assumes two earner family with top earner making 75% of their combined income.***
Note: Does not include EIC, FICA, or state income taxes. (Based on 2002 filer data estimates).

Priority #2: Treating All Middle Class Families More Fairly

Governor Bush believes it is imperative to ease the excessively high tax burden on middle class and upper middle class families – a burden that robs families of precious time together and resources to address pressing needs. As a result, one-third of the revenue cost of the plan's income tax cuts is related to changes that treat these families more fairly. These changes make the tax code pro-children and pro-marriage. Specifically, Governor Bush's tax cut plan would:

Cut the Maximum Marginal Rate for the Middle Class to 25 Percent: A new, lower maximum marginal tax rate of 25 percent would be established for the middle class. This 25 percent rate would apply to married couples with taxable income over $43,050, and to singles with taxable income over $25,750. Currently, these taxpayers face a marginal rate of 28 or 31 percent.

Greatly Reduce the Marriage Penalty: The marriage penalty would be cut by restoring the deduction for two-earner families. This would allow the lower-earning spouse to deduct 10 percent – up to $3,000 – of the first $30,000 of income. If each spouse earned $30,000, the marriage penalty would drop from $763 under the current code to $0 under the Bush code. On average, the two-earner deduction would eliminate roughly half of the marriage penalty for couples with combined incomes between $50,000 and $100,000. The marriage penalty would be further mitigated by the effect of the new, lower maximum rate of 25 percent, which would reduce the portion of the marriage penalty that derives from a progressive rate structure.

Raise the Threshold for the Phase-Out of the Child Credit: The starting point for the phase-out of the child tax credit would be raised from $110,000 to $200,000 for married couples, and from $75,000 to $200,000 for single parents.

As a result of these changes, a family of four earning $50,000 would receive about a 50 percent tax cut (returning over $1,900), and a family of four earning $75,000 would receive about a 25 percent tax cut (returning over $2,500).

Priority #3: Encouraging Entrepreneurship and Growth

Reducing marginal tax rates is the best way to promote economic growth through the tax code. Reducing the top rate in particular would spur entrepreneurial activity and help attract the best workers from around the globe to America. Governor Bush believes it is critical to reduce taxes on entrepreneurial success in order to help expand the economy through innovation. That is why one-sixth of the cost of the Bush income tax cuts would go to eliminating the success tax on entrepreneurs and creators of wealth. Specifically, the Bush tax cut plan would:

Cut the Top Marginal Tax Rates: The maximum marginal tax rates of 36 and 39.6 percent would be cut to 33 percent. This large reduction should provide a powerful economic stimulus to the economy over time.

High marginal tax rates are not the only limitation on wealth creation and risk-taking. The death tax also impedes economic growth because much of the capital formation in America occurs through estates. More capital means more tools and higher incomes for all workers. Since the marginal federal tax rate on savings can reach 73 percent (the 40 percent top income tax rate combined with the effect of the 55 percent top death tax rate), the death tax can also create a disincentive for seniors who want to save for their children or grandchildren.

The punitively high death tax falls most heavily on small businesses and family farms that are land rich but cash poor. According to a 1993 survey, nine of ten successors whose family businesses failed within three years of the owner's death listed the death tax as a contributing factor.

Finally, by encouraging tax avoidance through trusts and life insurance, the death tax may actually lower income tax revenue more than it raises death tax revenue. The tax has created an entire industry of lawyers and accountants. Compliance costs can reach 65 cents for every dollar raised in revenue, making this one of the most inefficient federal taxes.

Governor Bush believes that the bias of the death tax against the family farm and family business is the antithesis of the American Dream. Accordingly, the Bush tax cut plan would:

Eliminate the Death Tax: Eliminating the death tax would allow family farms and businesses to be passed from one generation to the next without having to break up or sell the assets to pay a punitive tax to the federal government. As a result, wealth would be taxed once – when it is earned, not again when entrepreneurs and senior citizens pass the fruits of their labors to the next generation.

A final impediment to innovation and economic growth is the uncertainty surrounding whether the current Research and Development tax credit will continue to exist. The R&D tax credit was originally enacted in 1981 and provides companies with a 20 percent tax credit for incremental R&D expenditures. According to one study, the credit yields a 31 percent return on investment – more than twice the rate of typical incentives. However, extensions of the tax credit have resulted in three gaps in coverage, two of which were retroactively filled. The on-again, off-again nature of the tax credit impedes long-term research. Thus, the Bush tax cut plan would:

Make the R&D Tax Credit Permanent: To create an environment that rewards investment in innovative technologies, the existing Research and Development tax credit would be made permanent. This should spur the sustained, long-term investment in R&D that America needs to develop the next generation of critical technologies – both civilian and military.

Priority #4: Promoting Charitable Giving and Education

Since the tax code first began in 1913, the law has recognized the importance of encouraging charitable giving by providing a deduction. Today, however, 70 percent of all filers – about 80 million people – cannot deduct their charitable donations because they do not itemize deductions. Thus, to encourage an outpouring of giving, the Bush tax cut plan would:

Expand the Federal Charitable Deduction: As President, Governor Bush will propose giving every taxpayer the ability to deduct his or her charitable donations. This change will generate billions of dollars annually in additional charitable contributions.

Permit Charitable Contributions from IRAs Without Penalty: Under current law, withdrawals from Individual Retirement Accounts are subject to income tax. This creates a disincentive for retirees to contribute some or all of their IRA funds to charity. Thus, Governor Bush supports legislation that would permit individuals over the age of 59 to contribute IRA funds to charities without having to pay income tax on their gifts.

Raise the Cap on Corporate Charitable Deductions: Under current law, a corporation can deduct charitable donations until their value exceeds 10 percent of the company's taxable income. As President, Governor Bush will propose legislation to raise this cap to 15 percent, encouraging firms to increase their giving to charities that address human needs.

Governor Bush's tax cut plan would also generate more resources for education. His plan recognizes that whether their children attend public, private, religious, charter or home schools, parents need funds to pay fees, buy books and supplies, cover transportation costs, and pay for tutoring and special needs. Thus, to empower parents with additional education resources, Governor Bush's tax cut plan would:

Expand Education Savings Accounts: Governor Bush would allow families or individuals with incomes up to $150,000 (or single earners with annual incomes up to $95,000) to contribute up to $5,000 annually per child into education savings accounts. Parents will be permitted to withdraw funds tax free (i.e., without being taxed on any gain or interest earned) to use for education-related purposes – from kindergarten to college.

Priority #5: Allowing Seniors to Work Without Penalty

Social Security recipients who continue to work lose a portion of their benefits due to the Social Security earnings test. Those who are age 62 to 64 lose $1 of benefits for every $2 they earn over $9,000, and those who are age 65 to 69 lose $1 of benefits for every $3 they earn over $15,500. This work penalty adds between 33 and 50 percentage points to the already high marginal rates in the income tax code. For this reason, the earnings test discourages Social Security beneficiaries from working. Thus, to allow seniors to work without penalty, the Bush tax cut plan would:

Repeal the Social Security Earnings Test: According to the Social Security actuaries, eliminating the work penalty would have little impact on the long-run financial status of the Social Security trust fund. By encouraging seniors to work longer, the repeal of the earnings test would boost Social Security tax revenue, increase general tax revenue, and decrease Medicare payments. Over time, these factors would more than offset the increase in Social Security benefits.

Distributional Impact of Governor Bush's Tax Cuts

Governor Bush's tax cuts would reduce income taxes for all Americans, but would especially benefit lower and middle-income families. For example, under the current code, a typical married couple with two children begins paying federal income taxes when their earnings reach $24,900. Under the Bush tax cut, this family would not begin paying taxes until its earnings reached $36,500. Similarly, under the current code, a single mother with two children begins paying taxes when she earns as little as $21,300. But under the Bush plan she would not become a taxpayer until her earnings reached $31,300 a year (see Chart 6). Many other lower-income taxpayers will see their income taxes slashed by over 50 percent. More affluent Americans also receive a tax cut, but they will also shoulder a larger portion of the federal income tax burden (see Chart 7). The result is an income tax burden that is fairer, yet lowers income taxes for all taxpayers.

CHART 7

UNDER THE BUSH TAX CUT PLAN, LOWER AND MIDDLE INCOME FAMILIES WILL SHOULDER LESS OF THE INCOME TAX BURDEN

Tax Burden by Income Bracket for 2004

	PERCENT OF TOTAL INCOME TAXES PAID		Percent Cut In Income Tax Burden
	Current Tax Code	After Bush Tax Cuts	After Bush Tax Cuts
Less than $10,000	-0.9%	-1.1%	100.0%
$10,000 to $20,000	-1.0%	-1.4%	100.0%
$20,000 to $30,000	2.2%	1.9%	28.3%
$30,000 to $40,000	4.1%	3.8%	20.1%
$40,000 to $50,000	5.4%	5.1%	17.9%
$50,000 to $75,000	14.6%	14.2%	15.8%
$75,000 to $100,000	13.6%	13.4%	14.6%
$100,000 to $200,000	22.8%	23.2%	12.1%
$200,000 and over	39.1%	40.9%	9.7%
Total, All Taxpayers	100.0%	100.0%	

Note: Distribution assumes that the Bush Plan is fully phased-in. Does not include the charitable deduction or the expansion of the education savings accounts, but does include EIC payments.

Impact of Governor Bush's Tax Cuts on Representative Taxpayers

- Single parent making $22,000 with 1 child: 100% reduction ($1,000)
- Single parent making $32,000 with 2 children: 95% reduction ($1,500)
- Married couple, each making $18,000, with 2 children: 100% reduction ($1,700)
- Married couple, each making $35,000, with 2 children: 35% reduction ($2,600)
- Married couple with one earner making $100,000, with 1 child: 15% reduction ($2,300)

Locking Up the Social Security Surplus

Governor Bush is committed to ensuring that all of Social Security's money is preserved for Social Security. That is why he is a strong supporter of Social Security lock box legislation, which would wall off the Social Security surplus from the rest of the budget. The lock box would ensure that all Social Security money is dedicated to paying benefits to current and future recipients and to modernizing the program for future generations. Thus, as President, Governor Bush would finance his tax cuts exclusively out of the "on budget," or non-Social Security surplus.

Financing Governor Bush's Tax Cuts Out of the Non-Social Security Surplus

Governor Bush's tax cut plan would return $460 billion to taxpayers over five years, fitting easily within the projected on budget surplus. His income tax cuts will be phased in over five years, and the repeal of the death tax will be phased in over eight years.